No. 11,046

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

ESTATE OF ETHEL M. DUVAL, deceased, by THOMAS M. ROBINSON, JR., and WESTON SHATTUCK ROBINSON, as executors of her last will and testament,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review a Decision of the Tax Court of the United States.

PETITIONERS' OPENING BRIEF.

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Table of Contents

Table of Authorities Cited

Cases

Statutes and Texts

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1.

JURISDICTIONAL STATEMENT.

By this proceeding, the above named petitioners seek a redetermination of a deficiency in federal estate taxes determined by respondent to be payable on account of the death of decedent.

The petitioners, as executors of decedent's estate, probated in Alameda County, California, filed their federal

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(NOTE): All *emphasis* herein is by petitioners, unless otherwise stated.

estate tax return in the office of the Collector of Internal Revenue for the First District of California, at San Francisco, California. The Collector's office is within the jurisdiction of the above entitled Court for the Ninth Circuit.

The provisions of Sections 1141 and 1142 of the Internal Revenue Code give jurisdiction to this Court.

The pleadings necessary to the existence of jurisdiction are the petition for redetermination of deficiency (T. pp. 3-17) and the answer thereto (T. pp. 18-20).

2.

STATEMENT OF THE CASE AND QUESTIONS INVOLVED ON APPEAL.

(a) Statement of the case.

1. This petition for review is concerned with the deductibility from decedent's gross estate of the claim of Bank of America National Trust and Savings Association for $175,000, based on decedent's absolute and unconditional guaranty of two notes of M. K. Blake Estate Company.

2. Mrs. DuVal and her sister Mary J. Robinson were shareholders of the M. K. Blake Estate Company (T. p. 23). The corporation borrowed money from Bank of America N. T. & S. A., evidenced by its notes (T. pp. 21-22) and secured by a deed of trust on its realty (T. p. 21).

3. The bank required Mrs. DuVal and her sister, Mrs. Robinson, to endorse and guarantee these notes, which they did (T. pp. 21 and 41).

4. Each of the two guarantees involved was absolute and unconditional, each containing the following waiver:

> "* * * and I hereby waive presentment, demand, protest, notice of protest and notice of nonpayment." (T. p. 8.)

When Mrs. DuVal died on April 9, 1942, the unpaid balance on these notes was $175,000 (T. p. 22).

5. The bank duly filed its probate claim on these absolute and unconditional guarantees with the executors in the California probate proceeding and the claim was allowed by the executors in July of 1942 (T. p. 24) and approved by the Probate Judge April 7, 1943 (T. p. 24).

6. In their first account, filed in the Probate Court, the executors reported this claim as allowed and approved (T. p. 24) and upon the settlement of the account on November 5, 1943 (T. p. 24), under Section 713 of the California Probate Code this claim, by operation of law, became an acknowledged debt of the estate, payable in due course of administration and its validity became uncontestable.

7. Since the claim was allowed and approved, under the Probate Code the decedent's estate could not be distributed without either payment of the claim *or* the bank's consent (11b *Cal. Jur.* p. 729, sec. 1247).

8. The executors and their attorney shortly prior to March 15, 1943 agreed on a plan of distribution (T. pp. 52-53) under which the estate is to be distributed to the testamentary trustee named in decedent's will *subject to the payment of the bank's claim* (T. p. 53).

9. This plan is still in force (T. p. 54) and the estate will be distributed under the plan (T. p. 54) and if the

trustee is called upon to pay the claim and the guaranteed debt is in default he will pay it (T. p. 55).

10. After the plan was adopted and on March 15, 1943, the attorney for the executors 'phoned to the bank's vice president, whom he had known for twenty years, *reminded him of the bank's claim, told him that with the claim allowed and approved the estate could not be distributed without the bank's consent, informed him of the plan to distribute the estate to the testamentary trustee subject to the bank's claim and asked if "on that basis" the bank would consent to distribution without payment of the claim* (T. pp. 51-52).

11. The vice president said he believed the bank would so consent and would let him know (T. p. 52) and under date of March 17, 1943, wrote the attorney a letter stating:

> "*In accordance with your request,* we are enclosing a 'Consent to Distribution' in the above named estate, reserving our claim, however, against Mary J. Robinson, as a co-guarantor on the note of M. K. Blake Estate Co. There is also enclosed a Withdrawal of Request for Special Notice." (T. p. 57).

12. The facts and circumstances under which the consent was requested from and given by the bank, as stated in paragraphs 10 and 11 are disclosed by positive and uncontradicted evidence. *There is no evidence in the record to show, and no finding that, the bank intended to relinquish its claim or to waive its rights.* The undisputed evidence is the other way.

13. The *"Consent to Distribution"* which was enclosed recited that Bank of America, a creditor of the

estate, by virtue of the guarantee by decedent of the promissory notes of M. K. Blake Estate Company

> "* * * hereby consents to the distribution of the above entitled estate without payment of its claim, hereby reserving, however, its claim against Mary J. Robinson who, with said decedent, guaranteed said promissory notes." (T. p. 24.)

14. The Internal Revenue Agent disallowed the deduction of the claim for $175,000 (T. p. 15) and review was sought in the Tax Court (T. pp. 3-12).

15. The Tax Court on February 2, 1945, promulgated its Findings of Fact and Opinion (4 T. C. No. 84) denying the petition and on February 3, 1945, entered its decision assessing a deficiency in the sum of $48,214.31 (T. pp. 3-12).

16. The Tax Court, in its opinion, holds that "From the *tenor* of the consent to distribution, especially its reservation of the claim against the co-guarantor, *we conclude*, that as to the petitioners, the bank had *abandoned* its claim and *relinquished* its right". (T. pp. 20-30).

17. We ask this Court to note that the Tax Court *expressly said* that it was *construing the language of the consent only,* in arriving at this conclusion and that the Tax Court completely ignored the undisputed relevant and material evidence, shown in paragraphs 8, 9, 10 and 11, supra, which shows what really was *intended* by the consent to distribution.

18. It is significant that the Tax Court failed to find that the bank *intended* to abandon its claim or relinquish its claim. But, it *construed* the "Consent to Distribution"

which, it concluded, abandoned the claim and relinquished the right.

19. In its opinion, the Tax Court also holds (a) that there has been no default on the notes or other event "*fixing the liability*" of the guarantor (T. p. 26), (b) that the bank's liability was not "*enforceable*" against the estate (T. p. 27), (c) that the decedent's liability does not attain to the dignity of a potential claim (T. p. 29) (d) that in fact there is no claim at all (T. p. 29), (e) that there was no valid or bona fide claim outstanding on the part of the bank (T. p. 28), (f) that the approval of the petitioners' contention will lead to absurd ends (T. p. 28).

20. At the trial, petitioners sought to prove by the witness Kittrelle, qualified as an expert witness (T. p. 41-2), that the decedent's alleged "rights over" (i.e., alleged rights of reimbursement, subrogation and contribution) had no fair market value as of the date of decedent's death. The Tax Court declined to admit the evidence.

21. The respondent offered no witnesses at the trial (T. p. 49).

22. The other facts are found in accordance with the evidence, except as shown in Specifications of Error Nos. III, IV, V and VI.

(b) Questions involved on appeal.

The Supreme Court in *Dobson v. Commissioner,* 320 U. S. 489, 88 L. Ed. (Adv. Op.) 179, 187, 64 S. C. 239, said:

> "* * * In view of the division of functions between the Tax Court and reviewing courts, *it is of course the*

duty of the Tax Court to distinguish with clarity between what it finds as a fact and what conclusions it reaches in the law. * * *''

In this case, the Tax Court made what it labelled ''Findings of Fact'' in which it purported to find the facts. This is followed by what is called its ''Opinion'' in which opinion the Tax Court's *conclusion* is as follows:

> ''From the *tenor* of the 'consent to distribution', especially its specific reservation of the claim against the co-guarantor, *we conclude* that as to petitioners, the bank had abandoned its claim and relinquished its right. *It follows* that the purported approval of the claim by the court was a vain and ineffective action of no legal standing or binding effect. *The consequence* is that, for Federal tax purposes, there was no valid or bona fide claim outstanding on the part of the bank and no basis for a deduction from the gross estate (T. pp. 27-28) * * *. The view we take in this case makes unnecessary consideration in detail of the several contentions advanced by the petitioners (T. p. 28). * * * In the present case, the *liability* does not attain to the dignity of a potential claim. In point of fact, there is no claim at all. * * * '' (T. p. 29).

The principal questions involved on the appeal are:

(1) Did the Tax Court err in construing I. R. C. Section 812(b) (3) as precluding the deduction from the gross estate of a probate claim based on decedent's primary and direct liability on absolute and unconditional guarantees?

(2) Did the Tax Court err in construing the Consent to Distribution *from its language alone* as hav-

ing the legal effect of a *waiver* of the bank's claim and as a *relinquishment* of the bank's right, capriciously, disregarding the facts and circumstances disclosed by the uncontradicted evidence, showing why the consent was *requested* and why it was *given* and in the absence of any finding that the bank *intended* a waiver or abandonment?

(3) Did the Tax Court err in excluding evidence of the fair market value of alleged "rights over" as of the date of decedent's death?

(4) Did the Tax Court err in construing and applying the laws of California as related to the subject matter of the tax controversy?

(5) Did the Tax Court invade the province of the legislative branch of the government in holding that the petitioners' contention "would lead to absurd ends"?

(6) Did the Tax Court err in arbitrarily and capriciously disregarding relevant, material and substantial evidence in the record and in failing to make findings of fact thereon?

These questions are all indicated in the assignment of error and are fully discussed in this brief.

3.

SPECIFICATIONS OF ERROR.

The petitioners specify the following errors:

I.

The Tax Court erred in holding that decedent's direct and primary liability on the absolute and unconditional guarantees could not form the basis for a claim deductible from decedent's gross estate under I. R. C. Section 812(b) (3).

II.

The Tax Court erred in treating decedent's primary liability on the absolute and unconditional guarantees as less than a "potential claim" and in denying deductibility of the claim on that account and because of the solvency of the maker and co-guarantor of the notes.

III.

The Tax Court erred in arbitrarily rejecting testimony offered by petitioners to prove that alleged "rights over" (i.e., alleged rights of contribution, subrogation and reimbursement) had no fair market value on the date of decedent's death.

IV.

The Tax Court erred in arbitrarily and capriciously making a partial finding of fact that conveys the erroneous idea that a plan for distributing decedent's estate has been abandoned, which partial finding is contrary to the undisputed evidence.

V.

The Tax Court erred in arbitrarily and capriciously failing to find the facts and circumstances and conditions under which the testamentary trustee requested and the bank gave its consent to distribution, which facts, circumstances and conditions are shown by the undisputed evidence.

VI.

The Tax Court erred in construing the legal effect of the consent to distribution as a waiver of the bank's claim and as a relinquishment of its rights, disregarding the facts, circumstances and conditions under which it was requested and given.

VII.

The Tax Court erred in concluding that the approval of the bank's claim by the probate judge "was a vain and ineffectual action of no legal standing or binding effect."

VIII.

The Tax Court erred in concluding, contrary to law, that the approval of petitioners' contention "would lead to absurd ends", thus invading the province of the Congress, which should act if the law is unwise or requires change.

4.

ARGUMENT.

INTRODUCTION.

We believe time will be saved and clarity of presentation facilitated by stating, in advance of the argument upon the Specifications of Error, the principles of law governing the deductibility of probate claims under the Federal Estate Tax law and regulations and the law governing decedent's liability upon the guaranty upon which the probate claim is founded. All of these matters were presented in the briefs before the Tax Court, but were disregarded by the Tax Court which said (T. p. 28) that the view it took of the case made unnecessary the consideration of these points.

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(1) THE STATUTORY BASIS FOR THE DEDUCTION OF THE CLAIM.

Section 812(b) (3) of the Internal Revenue Code provides:

> "For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate * * *
>
> (b) such amounts * * *
>
> (3) for claims against the estate * * * as are allowed by the laws of the jurisdiction, whether within, or without the United States, under which the estate is being probated. * * * The deduction herein allowed in the case of claims against the estate * * * shall, when founded upon a promise or agreement, be limited to the extent that they were contracted bona

> fide and for an adequate and full consideration in money or money's worth. * * *"

Section 81.36 of Regulations 105 is clear and explicit. It provides:

> "The amounts which may be deducted under this heading are such only as represent *personal obligations* of the decedent, existing at the time of his death, *whether or not then matured.*"

We are here dealing with the statute *prior* to amendment on October 21, 1942.

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(2) THE DECEDENT'S GUARANTY WAS SUPPORTED BY CONSIDERATION.

We mention this, although the contrary is not suggested in the Tax Court's findings or opinion. The Tax Court does find that the guarantees were executed at the bank's request when the notes were executed (T. p. 21).

Section 2792 of the California Civil Code provides that when a suretyship obligation is entered into "at the same time with the original obligation" and "forms with that obligation a part of the consideration to him, *no other consideration need exist*". (Prior to its amendment, the section used the word "guaranty" instead of "surety").

The uncontradicted testimony in this case is and the Tax Court found that the bank requested Mrs. DuVal and her sister, Mrs. Robinson, to guarantee and endorse these notes (T. p. 41).

This was a clear case of a commercial guaranty in which the principal monetary consideration went to the corpo-

ration whose notes were guaranteed rather than to decedent and it is immaterial that the consideration did not flow directly to decedent or her estate: 1 *Paul* on *Federal Estate and Gift Taxation,* p. 602, Sec. 11.20; *Commissioner v. Porter* (CCA-2), 92 Fed. (2d) 426; *Carney v. Benz* (CCA-1), 90 Fed. (2d) 747, and *Wragg v. Commissioner* (CCA-1), 141 Fed. (2d) 638, 639.

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(3) THE RIGHT TO DEDUCT A CLAIM DERIVES FROM THE STATUTE AS A MATTER OF LEGISLATIVE GRACE AND IS NOT BASED ON EQUITABLE CONSIDERATIONS OR UPON GENERAL PRINCIPLES OF LAW AND DOES NOT DEPEND UPON ANY DISCRETION VESTED IN THE COMMISSIONER.

This, we submit, is settled law. (1 *Paul* on *Federal Estate and Gift Taxation,* p. 573, Sec. 11.02). In *Deputy v. DuPont,* 308 U. S. 488, 84 L. Ed. 416, 60 S. Ct. 363, it is said that the allowance of deductions from gross income "*does not turn on general equitable considerations.* It depends upon *legislative grace.* * * *" In *Commissioner v. Lyne* (CCA-1), 94 Fed. (2d) 745, where the Commissioner argued that he had a "*certain discretion* in determining what deductions should be allowed", the Court said that the language of the statute "seems too direct and mandatory to permit of such discretionary action on his part. * * *" And in *Porter v. Commissioner,* 288 U. S. 436, 441, 77 L. Ed. 880, 53 S. Ct. 451, in referring to the taxable "net estate" under Section 301(a) of the act involved, the Court said:

> "* * * The net estate as there used *does not mean an amount to be ascertained as such under any general rule of law* or under statutes governing the administration of estates, but it is the gross estate as spe-

cifically defined in Sec. 302 less deductions permitted by Sec. 303 * * *''.

In *Commissioner v. Hallock* (CCA-6), 102 Fed. (2d) 1 (reversed on other grounds, 309 U. S. 106), referring to the *''simple mathematical calculation''* specified by the statute to fix the net estate, the Court said:

> '' * * * The elements of both sets of factors are specifically enumerated in the Act and to some extent items going into the gross estate as well as deductions *have been arbitrarily chosen by the Congress.* * * *''

In *U. S. v. Mitchell* (CCA-7), 74 Fed. (2d) 571, 575, the Court says:

> ''We are unable to accept the government's contention. *While deductions are a matter of statutory allowance, and are not determined on the basis of equity, yet it is legitimate to assume that Congress intended to provide a tax on net estates* and that, in determining net estate, deductions for debts might be made. * * *''

And in *Helvering v. O'Donnell* (CCA-2), 94 Fed. (2d) 852, 853, the Court says:

> ''* * * This *statute* fixes the basis for the tax * * * But the classes of property which must be included in the gross estate are specified, *however arbitrary they seem.* * * *''

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(4) THE COURTS HAVE UNIFORMLY HELD THAT SEC. 812(b)(3) IS PLAIN AND UNAMBIGUOUS.

The following cases dispel any notion that there is anything ambiguous or uncertain about the meaning of

the statute. It *says* what it *means* and it *means* what it *says: Helvering v. Northwestern Nat. Bank* (CCA-8), 89 Fed. (2d) 553; *Commissioner v. Lyne* (CCA-1), 90 Fed. (2d) 745; *Helvering v. O'Donnell* (CCA-2) 94 Fed. (2d) 852; *Commissioner v. Hallock* (CCA-6) 102 Fed. (2d) 1; *Commissioner v. Ames* (CCA-7) 88 Fed. (2d) 338; *Commissioner v. Windrow* (CCA-5) 89 Fed. (2d) 69.

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(5) THE CLAIM IS ONE THAT WAS ALLOWED BY THE LAWS OF CALIFORNIA, THE JURISDICTION WHERE PROBATE IS PENDING.

It is not even necessary that a claim be filed in order that it may be deducted from the gross estate. *Buck v. Helvering* (CCA-9) 73 Fed. (2d) 760, 764. *Commissioner v. Strauss* (CCA-7) 77 Fed. (2d) 401, 402. Nor is it necessary that a claim be allowed by the Court. (*Helvering v. Northwestern Nat. Bank* (CCA-8) 89 Fed. (2d) 553, 556.)

In *Union Guardian Trust Co.*, 32 BTA 996, 999, it is said:

> "* * * The *right* to payment is what determines the question. If the claimant has a *right* to payment before the net estate subject to administration can be distributed, pursuant to the will or the laws relating to intestacy, *his claim is allowed by the law.* * * *"

Section 812(b) (3) says that a claim is deductible if allowed by the laws of the jurisdiction under which the estate is being administered. Section 707 of the California Probate Code provides that

> "All claims arising upon contracts, whether they are due, not due or contingent * * * must be filed or

> presented within the time limited in the notice * * * and any claim not so filed or presented is barred forever.''

It is settled law in California (11a Cal. Jur. p. 680, sec. 485), that

> ''Whatever signification may be attached to the term '*claim*' standing by itself, in the statute relating to *presentation of claims* for payment has reference *only* to such debts or demands against decedent as might, if due, have been enforced against him in his lifetime by *personal actions for recovery of money* and upon which only a money judgment could have been rendered. * * *''

The bank's claim on file herein is such a ''claim''.

The Tax Court found (T. p. 24) that the bank's claim in this case was duly filed and was allowed by the executors and approved by the Probate Judge.

Section 713 of the California Probate Code provides that

> ''Every claim allowed by the executor * * * and approved by the judge *shall be ranked among the acknowledged debts of the estate* * * *''

The Tax Court found (T. p. 24) that on October 25, 1943, the executors filed in the Probate Court their first account, reporting, among other things, the filing of this $175,000 claim, its allowance by them and its approval by the judge.

Section 713 of the California Probate Code, quoted in part in the paragraph above, continues:

> ''* * * but the validity thereof may be contested by any person in interest at any time prior to the settle-

ment of the account of the executor or administrator *in which it is first reported as an allowed and approved claim.* * * *''

Thus, when the Tax Court also found that on November 5, 1943, the Probate Court settled the executors' first account reporting the allowed and approved claim, it was not only an *acknowledged debt of the estate,* but *by operation of law,* under Probate Code sec. 713, it became *incontestable* as well.

The claim meets the test prescribed by Section 812(b) (3)—*it was a claim allowed by the laws of California.*

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(6) IT IS WHOLLY IMMATERIAL THAT THE CLAIM MAY OR CAN NEVER BE PAID BY DECEDENT'S ESTATE.

This is settled law under a series of decisions under Sec. 812(b) (3) *prior to its amendment* on October 21, 1942 (This decedent died in April, 1942).

In *Commissioner v. Strauss* (CCA-7) 77 Fed. (2d) 401, the claims involved were neither presented, allower *nor paid.* The court said (page 405):

> ''The *statute* governs in either case. Sec. 303(a) (1) Revenue Act of 1926 (26 USCA Sec. 1095 (a) (1) *does not require* the allowance of the debt by the court *or its payment* by the estate in order that it may be deducted from the gross estate. * * *''

In *Commissioner v. Windrow,* (CCA-5), 89 Fed. (2d) 69, 71, in construing Sec. 303(a) (3) of the Act of 1926, as amended in 1932, the Court said:

> ''* * * We cannot, if we would amend the statute to read '*The value* of claims against the estate' or

'claims against the estate *so far as paid'*. (Emphasis by the Court). Congress did limit claims in respect of their allowance *in law;* it *did not limit them in respect of their payment or payability.*"

In *Helvering v. Northwestern Nat. Bank, etc.* (CCA-8) 89 Fed. (2d) 553, at page 556, the Court said, referring to Sec. 303(b) (3) (1926 Act as amended in 1932):

"* * * The statute clearly provides that the entire amount of claims against the estate, *whether allowed by the Court or paid by the estate or not,* must be deducted (citing cases). * * *"

In *Commissioner v. Lyne* (CCA-1) 90 Fed. (2d) 745, 746, the Court said:

"* * * It is said for the Commissioner that the expression in the statute 'such amounts for claims against the estate as are allowed' should be construed as meaning *'allowed and paid.'* (Emphasis by the Court.) There is nothing in the statute which warrants giving the word 'allowed' such an uncommon meaning. * * *"

In *Helvering v. O'Donnell* (CCA-2) 94 Fed. (2d) 852, at page 853, the Court said:

"* * * Petitioner argues, however, that the deduction of claims should be limited to only those *allowed and paid. The act, however, does not so read and we cannot assume that Congress so intended.* * * *"

In *Commissioner v. Hallock* (CCA-6) 102 Fed. (2d) 1, 5, the Court said:

"* * * The fact that the estate may not be called upon to pay the debt *is no concern of the Court.* * * *"

In *Eleanor Landsburgh, Administratrix,* 35 BTA 928, 936, the Board said:

> "Petitioners' second contention is that the deductions from gross estate should include all lawful debts and funeral and administration expenses, *regardless of amount of assets in the hands of the administratrix.* This question has been definitely settled in favor of petitioners' contention (citing cases) * * *".

See also *Thomas DeC.Ruth, et al., Executors,* 36 BTA 191, 194, and *Edna F. Hays, et al., Executors,* 34 BTA 808, 812.

Therefore, the fact that this claim *may* never be paid or *will* never be paid is wholly immaterial, all of which is consistent with and follows from the proposition that the basis for deductibility is the *liability* of the decedent.

The Tax Court cites *Buck v. Helvering* (CCA-9) 73 Fed. (2d) 760, where this Court referred to a claim based on shareholders' liability, *which was actually paid by the corporation during administration,* as one *"not at all likely ever to be enforced"* and referred to the claim as "potential".

It is submitted that the settled line of decisions of the Courts is that the deductibility of a claim is not affected by the fact that it *may* not or *can* not or *will* not ever be paid. The test is the *personal obligation of the decedent at the time of her death.*

(7) IN EVALUING THE NET ESTATE FOR TAX PURPOSES THE VALUE MUST BE DETERMINED FROM DATA AVAILABLE AT THE TIME OF DECEDENT'S DEATH.

This Court in *Wells Fargo Bank & Union Trust Co. v. Commissioner* (CCA-9-Oct. 1944) 145 Fed. (2d) 132, holds that the Tax Court was in error in that case, when it permitted evidence of an actual invasion of the trust involved, to influence its decision. This Court cited *Ithaca Trust Co. v. U. S.*, 1929, 279 U. S. 151, 155, 49 S. Ct. 291 73 L. Ed. 647, where the Supreme Court said:

> "The estate, as far as may be, is settled as of the date of testator's death (citing cases). The tax is on the act of the testator and not on the receipt of property by the legatees (citing cases). *Therefore the value of the thing to be taxed must be estimated as of the time when the act is done*".

Again, this Court quoted from *United States v. Provident Trust Co.*, 1934, 291 U. S. 272, 281, 54 S. Ct. 389, 390, 78 L. Ed. 793, that in making a *deduction* for a charitable remainder

> "the value thereof must be determined from data available at the time of the death of decedent".

This Court also referred to its opinion in *Commissioner v. Wells Fargo Bank & Union Trust Co.* (CCA-9) 145 Fed. (2d) 130.

See also *Guggenheim v. Helvering* (CCA-2) 117 Fed. (2d) 469 (Cert. Den. 314 U. S. 621, 86 L. Ed. 499, 61 S. Ct. 66) involving the valuation of certain securities, which decreased in value after decedent's death. The Court said:

"* * * What happened later has nothing to do with the case. * * *"

citing the *Ithaca Trust Co.* case supra.

In this same connection, note the provisions of Sec. 81.36 of Reg. 105, which are clear and explicit:

"Claims Against The Estate: The amounts that may be deducted under this heading are such only as represent personal obligations of the decedent, *existing at the time of his death,* whether or not then matured and the interest thereon which has accrued *at the time of his death* * * *".

The date of decedent's death is the basic date for fixing the amount of claims and *what may happen afterwards has nothing to do with the case.*

Yet the Tax Court speculates that the corporation or the co-guarantor *might* pay the claim at some indefinite time in the future.

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(8) THE GUARANTY EXECUTED BY DECEDENT IN WHICH SHE WAIVED PRESENTMENT, DEMAND, PROTEST, NOTICE OF PROTEST AND NOTICE OF NON-PAYMENT WAS AN ABSOLUTE AND UNCONDITIONAL GUARANTY UNDER WHICH THE DECEDENT INCURRED A DIRECT AND PRIMARY LIABILITY.

Section 2806 of the California Civil Code provides that "a suretyship obligation is to be deemed *unconditional* unless its terms import some condition precedent to the liability of the surety." In 1939, the Civil Code abolished the distinction between guaranty and suretyship (Civil Code, Sec. 2787). Prior to that time Sec. 2806 used the word "guaranty" instead of "suretyship".

Because of the express waivers contained in each guaranty and because of Sec. 2806, both guarantees are *absolute* and *unconditional.* In 13 Cal. Jur. page 93, section 9, it is said that

> "* * * An *absolute* guaranty is an *unqualified* undertaking that if the debtor fails of performance, the guarantor will perform; whereas a *conditional* guaranty contemplates the happening of some contingency, such as the exhaustion of remedies against the principal debtor, the exhaustion of other security, the procurement of a particular fund, immediate suit upon default by the debtor, demand and notice, or an accounting before the guarantor is liable upon the contract."

Under these *absolute* and *unconditional* guarantees, decedent's liability was *direct* and *primary* and the creditor could enforce liability directly against decedent without prior recourse either to the deed of trust securing the guaranteed notes, or, against the principal. Thus, in 13 Cal. Jur., page 110, section 22, it is said:

> "Exhaustion of Remedies Against Debtor.—The liability of the guarantor of an absolute and unconditional guaranty is fixed when the principal obligation matures and is not predicated upon the exhaustion by the creditor of his remedies against the principal debtor, or the exhaustion of other security for the debt; and it is immaterial whether the debtor can or cannot pay the debt. A guaranty is a separate and independent contract, so that if the principal obligation is secured by both a guaranty and a mortgage, *the creditor may resort to either one* or the other for his debt and the guarantor cannot force him to proceed against the security."

There can be no doubt that liability on an *absolute* and *unconditional* guaranty is *primary,* not secondary. In *McDonald v. Gravenstein, etc. Assn.,* 42 Cal. App. (2d) 329, 108 Pac. (2d) 936, an owner signed the contract between his tenant, an apple grower and a fruit growers association *as guarantor.* He signed *as guarantor* so that this tenant could get the capital and supplies for properly carrying out his lease. The Court said:

> "* * * The promise to pay is *absolute* and *unconditional;* therefore, the liability of the guarantor is fixed when the principal obligation matures and is not predicated upon the exhaustion by the creditor of his remedy against the original debtor (13 Cal. Jur. Sec. 22 p. 110.)
>
> Applying the foregoing legal principles to the facts as established here, there was ample evidence to support the finding that appellant (guarantor) was *primarily liable for the indebtedness, notwithstanding that he did not personally receive any of the money or goods which are the basis of the account.*"

(On February 6, 1941, the Supreme Court of California denied a petition for a hearing in this case.)

Under the law of California, decedent's liability was *incurred when the guaranty was executed* and required neither default upon the notes or any other event to "fix" the guarantor's liability. Thus in 13 Cal. Jur., p. 108, sec. 21 it is said:

> "Liability on a guaranty is *incurred at the date of the guaranty,* although the liability is unenforceable until the principal obligation matures. * * *"

And in *First Nat. Bank v. Consolidated Lumber Co.,* 16 Cal. App. 267, 116 Pac. 680, the Court considered the

question of when liability on a guaranty is incurred—when the guaranty is made or when it is enforced? It held that liability is incurred when the guaranty is made. At page 268, the Court said:

> "It is quite true that the liability incurred by the Newport Lumber Company was not enforceable until the maturity of the note and default made by the makers thereof. *It cannot, however, be said that the liability was not created until such time. Liability does not depend for its existence upon the fact that it is immediately enforceable.* It may exist without the right of immediate enforcement. (*White v. Green,* 105 Iowa, 176 (74 N. W. 928); *Hunt v. Ward*, 99 Cal. 615 (37 Am. St. Rep. 87, 34 Pac. 335).) * * * Under the terms of the contract, the liability incurred by the Newport Lumber Company was absolute, although the right of the plaintiff to enforce such liability depended upon a contingency, namely: the default of the makers of the note; *but this fact did not render the liability contingent.* There is a marked distinction between a contingent liability and the right contingent upon the happening of an event to enforce an existing liability. In the one case, there is no liability until the happening of the event, the occurrence of which creates the liability, while in the other *the liability exists,* but the right to enforce it depends upon the contingency. Here there was an existing indebtedness in a sum specified in the note which the makers promised to pay to the holder thereof. By its contract of guaranty the corporation agreed that it would pay this indebtedness when the same was due, if the makers of the note failed to pay it. It follows, we think that the liability was created on August 31, 1905, *at the time when the corporation by contract, obligated itself to make the payment.* If this be true,

> the cause of action to enforce defendant's statutory liability as a stockholder of the Newport Lumber Company was barred in three years from said date."

(The Supreme Court of California denied a petition for a hearing in this case.)

The Tax Court says that "only claims which are *enforceable* against the estate are deductible," citing *United States v. Mitchell* (CCA-7) 74 Fed. (2d) 571. In that case, the claim was based on an obligation that was *voidable*. At page 573 the Circuit Court said:

> "nor can an asserted obligation which was *enforceable only at the option of the deceased obligor be deducted*. The mere fact that a contract within the statute of frauds is *voidable* and not void does not permit the executors of the estate to waive the obligor's defense after the latter's death so as to avoid an estate tax."

Since this decedent's obligation was neither "voidable" nor "void", it is obvious that a claim based thereon was clearly *enforceable* against decedent's estate.

In view of what is said in Sec. 81.36 of Reg. 105, supra, it is important to note that decedent had a *direct personal liability* under the guaranty, existing at the time of her death. It is *liability*, not payment, that determines deductibility.

5.

POINTS AND AUTHORITIES.

I.

THE TAX COURT ERRED IN HOLDING THAT DECEDENT'S DIRECT AND PRIMARY LIABILITY ON THE ABSOLUTE AND UNCONDITIONAL GUARANTEES COULD NOT FORM THE BASIS FOR A CLAIM DEDUCTIBLE FROM DECEDENT'S GROSS ESTATE UNDER I.R.C. SECTION 812(b)(3).

In its opinion, the Tax Court said (T. p. 26) that "There has been no default on the notes or other event *fixing the liability of the guarantor*". This is obviously error, because as shown in (8) of the Introduction, supra, decedent's liability was already in existence and she had already incurred her liability under the guaranty when she signed it and the fact that it had not matured when she died is wholly immaterial under Reg. 105, Sec. 81.36, as shown in (1) of the Introduction.

The Tax Court further said (T. p. 27) that "Only claims which are *enforceable* against decedent's estate" may be deducted, citing *U. S. v. Mitchell*, 74 Fed. (2d) 571, involving a claim based on a *voidable* contract. As shown in (8) in the Introduction, the guaranty signed by decedent was valid and in no sense lacking in enforceability, and the Tax Court's conclusion is clearly erroneous.

The Tax Court further held (T. p. 29) that "In the present case the *liability* does not attain to the dignity of a potential claim. In point of fact there is no claim at all". This is error, because, as shown in (8) in the Introduction, decedent had incurred a *direct and primary liability* under the guaranty. Sec. 81.36 of Reg. 105 adopts

as the test for deductibility the *personal obligation* of the decedent and this liability she had.

Petitioners respectfully submit that the direct and primary liability of decedent under these guarantees satisfies all liability requirements of the statute.

These were commercial guarantees, there is no finding of bad faith and, as shown in (5) in the Introduction, the claim was one clearly "allowed" by the laws of the jurisdiction (California) and they were supported by consideration, as required by statute.

II.

THE TAX COURT ERRED IN TREATING DECEDENT'S PRIMARY LIABILITY ON THE ABSOLUTE AND UNCONDITIONAL GUARANTEES AS LESS THAN A "POTENTIAL" CLAIM AND IN DENYING DEDUCTIBILITY OF THE CLAIM ON THAT ACCOUNT AND BECAUSE OF THE SOLVENCY OF THE MAKER AND THE CO-GUARANTOR OF THE NOTES.

The Tax Court concluded that a claim based on a guaranty is not deductible from the decedent's gross estate because it found, as a fact, that (T. pp. 24-5) "at the date of the decedent's death and at all times since, to the date of the hearing herein, both the maker of the notes, M. K. Blake Estate Company and the co-guarantor, Mary J. Robinson, have been solvent and fully able to pay the notes in question".

The Tax Court, in its opinion, says that petitioners' position is much weaker than that present in the *Charles H. Lay,* 40 BTA 522 case, where it was said that where an estate is liable only as a *surety* or *endorser,* it cannot

take any deduction because of such liability where the principal has ample assets to pay the indebtedness.

This of course, erroneously assumes that the decedent in the present case had a *secondary* liability on her guaranty, *whereas, as above shown, her liability was direct and primary.*

The question of whether a claim based on *secondary* liability is deductible was squarely presented in *Commissioner v. Wragg* (CCA-1) 141 Fed. (2d) 638, 639, which analyzes the rationale of deductions from the gross estate based on the usual form of guarantees, etc. In this case the Commissioner argued that decedent's *secondary* liability could not form the basis for a deduction unless the value of decedent's rights over against the primary obligor were included in decedent's gross estate. The Circuit Court said (p. 640):

> "The statute makes no specific mention of rights of reimbursement, contribution or indemnity, but it does provide for inclusion in the gross estates of decedents of the value at the time of death of 'all property, real or personal, tangible or intangible, wherever situated' (Sec. 302 of the Revenue Act of 1926, 44 Stat., Part II, p. 70, 26 U. S. C. A. Int. Rev. Acts, page 227), and these words are clearly broad enough to include such rights. The courts in the cases to be cited hereafter have at least tacitly, so construed them. *The crucial question in cases of this sort is what such a right is worth.* If it is worth one hundred cents on the dollar an estate will not be reduced by a secondary obligation of the decedent, *but if it is worth nothing, a secondary obligation will be as effective as a primary one to reduce the net value of*

> *an estate.* It is upon this truism that the Courts and the Board of Tax Appeals appear, if inarticulately, to have proceeded in the past."

The Circuit Court then proceeded to analyze the cases and said (p. 640):

> "Thus when it has appeared that the decedent's right over against the primary obligor was worth its face value, no deduction has been allowed for a secondary liability (citing cases); but when it has appeared that the right over was valueless a deduction for it has been allowed (citing cases). And, when it has appeared that the right was worth something but not its face value a deduction has been allowed to the extent of the amount which actually had to be paid and could not be recovered from the primary obligor by the estate (citing cases)."

As shown in the next subdivision of this brief, the petitioners offered evidence at the trial to prove that these rights over *had no fair market as of the date of decedent's death* and the refusal to admit this testimony was clearly error.

The *Wragg* case, we submit, is a clear analysis of the rationale for deducting a claim based upon a *secondary* liability. But in our present case, the liability on the guaranty is *primary* and *direct* and it is accordingly not necessary to resort to the reasoning of the *Wragg* case.

The error of the Tax Court is thus two-fold: (1) In excluding evidence of the value of the rights over if it felt that decedent's liability was *secondary*, and (2) in failing to consider that this decedent's liability on the guarantees, *which was a primary liability* and not a

secondary liability, formed the basis for a claim deductible from decedent's gross estate.

Furthermore, on the basis of the settled law of California, *there were no rights of contribution, subrogation or reimbursement in existence when decedent died which could be included in her estate or valued as of the date of decedent's death.* (These points the Tax Court refused to consider).

Whatever the law may be in other jurisdictions, *the law on this point is clear in California* where these guarantees were executed.

The law in California is that *no rights of contribution, reimbursement or subrogation exist unless and until the guarantor actually pays the guaranteed debt.*

When he does pay, the rights of contribution, reimbursement and subrogation which he may enforce are *based upon a new implied contract based on equitable principles and not on the original guaranty:*

REIMBURSEMENT: *No liability arises* to reimburse the guarantor *until the guarantor pays* the guaranteed notes. (*Wills v. Woolner* (1913) 21 Cal App. 528, 132 Pac. 283; *Baker v. Ackers* (1938) 29 Cal. App. (2d) 162, 84 Pac. (2d) 264; 13 Cal. Jur. p. 112, Sec. 30.) According to *Wills v. Woolner,* supra, "*regardless of authorities which may be cited from other forums*", this principle "*must be accepted as the settled law of this state*".

SUBROGATION: In 23 Cal. Jur., page 941, section 19, it is said:

> "As a general rule, the doctrine of subrogation *requires* that the person seeking its benefit *must have*

> *paid a debt* due to a third person *before* he can be substituted to that person's rights; it is not a liability to pay, *but an actual payment to the creditor which raises the equitable right.* * * *''

The doctrine of subrogation is essentially a creature of equity. In *Meyers v. Bank of America* (1938) 11 Cal. (2d) 92, 97, 77 Pac. (2d) 1084, the Court quotes from 60 C. J. page 749 (emphasis by the Court):

> ''While the creditor may properly make an assignment of his rights and remedies to the surety where the surety is *entitled* to be subrogated, the completion of the surety's obligation and his right to pursue the rights and remedies of the creditor, is not dependent on the willingness of the latter to make an assignment, *for in equity the surety's payment causes an assignment by operation of law and no formal assignment or transfer is necessary.* * * *''

Furthermore, the right of subrogation is only *a right to a lawsuit.* Thus in *Jack v. Wong Shee,* 33 Cal. App. (2d) 402, 92 Pac. (2d) 449, at page 411 the Court said:

> ''* * * It is true that under the law as it exists today *the right of subrogation is not one which a party may assert by his own action, but is one which may be asserted only in a civil action.* (*Offer v. Superior Court,* 194 Cal. 114, 117; 23 Cal. Jur., 945; 25 R.C.L. 1391, sec. 794) * * *''.

CONTRIBUTION: There is no *right* of contribution in California *until the guarantor has paid more than his share of the debt.* The right of contribution *does not even have an ''inchoate'' existence* prior to the time that the guarantor pays more than his share. When he does pay more than his share, his action for contribution arises

and *does not depend on the original contract of guaranty, but upon a new implied contract founded on principles of equity and natural justice* and comes from the application of principles of equity to the condition in which the parties are found, in consequence of some of them as between themselves, *having done more than their share* in performing a common obligation. *Pacific Freight Lines v. Pioneer Express Co.,* (1940), 39 Cal. App. (2d) 609, 103 Pac. (2d) 1056; *Jackson v. Lacy,* (1940) 37 Cal. App. (2d) 551, 559, 100 Pac. (2d) 313; *Richter v. Henningsen* (1895) 110 Cal. 530, 537, 42 Pac. 1077.

In this connection, we may say that we are familiar with *Parrott v. Commissioner* (CCA-9, 30 Fed. (2d) 792, wherein at page 793, the Court said:

> "* * * It is no answer to this to say that, since the testatrix had not paid the entire obligation in her lifetime, no liability on the part of her brother to reimburse her existed at the time of her death, which could be said to be property to be included in her gross estate. *At the time of the death of the testatrix, her brother was under contractual obligation to pay his half of the debt, and to repay to her any sum that she might pay in excess of one half of the amount of their joint debt, and that obligation existed from the date of the execution of the note and the mortgage and was property. Rice v. Southgate,* 16 Gray (82 Mass.) 142; *Griffin v. Long,* 96 Ark. 268, 131 S. W. 672, 35 L.R.A. (N.S.) 855, Ann. Cas. 1912B 622; *Norris v. Churchill,* 20 Ind. App. 668, 51 N.E. 104".

The point to be specially noted is that while the three cases cited, *Rice v. Southgate* (Mass.), *Griffin v. Long* (Ark.), and *Norris v. Churchill* (Ind.) do hold that the

right of *reimbursement* and contribution involved in those cases *exists from the date that the contract of suretyship or guaranty was executed,* we have just demonstrated that although this may be the law in *other* states, *it definitely is not the law of California* where, as shown in the *Pacific Freight Lines* case, supra, a right of contribution doesn't even have an *inchoate* existence until the guarantor pays more than his share of the debt.

Whatever the law is in Massachusetts, Arkansas and Indiana, *that is not the law in California* where these guarantees were executed and under California law, there were no rights of reimbursement, subrogation or contribution in existence on the basic valuation date, the date of decedent's death, which could be included in the gross estate.

Mrs. Robinson, the decedent's co-guarantor, was not under any *contractual* obligation to pay to Mrs. DuVal any part of the guaranteed debt *when the guaranty was signed.*

The principle that rights such as those of contribution, reimbursement and subrogation do not exist until the guarantor or endorser *actually pays* is well established by decisions of the Board of Tax Appeals: *Badenhausen,* 7 BTA 910, 912; *Howell,* 22 BTA, 140, 147.

The impropriety of including in the gross estate rights not in existence at decedent's death is well illustrated in *Skinker,* 13 BTA 846; *Rodick,* 33 BTA 1020; *U. S. v. Safety Car & Lighting Co.,* 297 U. S. 88, 56 S. Ct. 353, 80 L. Ed 500.

It is submitted that the Tax Court erred as above stated and that this is a clear cut error of law, also.

III.

THE TAX COURT ERRED IN ARBITRARILY REJECTING TESTIMONY OFFERED BY PETITIONERS TO PROVE THAT ALLEGED "RIGHTS OVER" (i.e., ALLEGED RIGHTS OF CONTRIBUTION, SUBROGATION AND REIMBURSEMENT) HAD NO FAIR MARKET VALUE ON THE DATE OF DECEDENT'S DEATH.

In Specification of Error II we have shown the importance of valuing rights over in cases where claims against estates are founded on *secondary* liability.

The petitioners here sought to prove that the rights over had no fair market value on the date of decedent's death and the offered testimony was rejected by the Tax Court.

The record shows:

R. W. Kittrelle was called as a witness on behalf of petitioners and was first examined in order to qualify him as an expert appraiser. He testified:

> I am a real estate broker and appraiser, have been engaged in that business for a little over 38 years and am now the appraiser for Central Bank of Oakland and have been for the last 17 years, and for the First Federal Savings, Alameda Federal Savings, Connecticut Mutual Life Insurance Company, and quite a few others. As such an appraiser, I appraised real property, personal property, tangible personal property, intangible personal property. I have had occasion during the period above indicated to testify in court as an expert appraiser for all of the types of property indicated, have testified in the Alameda County Superior Court and Federal Court in San Francisco (T. p. 42).
>
> I have examined the bank's claim which is Petitioners' Exhibit 2 in this case and the promissory

notes that are attached thereto and the contracts of guaranty that have been endorsed thereon and *I am familiar with the rights of the parties* (T. pp. 42-3.)

The witness was not cross-examined by counsel for the respondent who in response to a question by the Court "Have you any objection?" answered "No, I have no objection. I admit that he is a qualified appraiser of real property and * * *" (T. p. 43).

The witness was thereupon asked the following question:

"Ethel M. DuVal, who died April 9, 1942, in her lifetime, with her sister, Mary J. Robinson, endorsed and guaranteed certain promissory notes for M. K. Blake Estate Company, in favor of Bank of America, National Trust & Savings Association, for the principal balance of $175,000 payable August 2, 1944, and interest thereon at the rate of Four and One-Half per cent (4½%) per annum, which said principal balance remains unpaid and if Ethel M. DuVal's estate is required to pay the entire amount of said notes at some indeterminate time after April 9, 1942, it will, after making such payment, then be entitled to a right of contribution against Mary J. Robinson if Mary J. Robinson is then alive (or against her estate if she is then deceased and if the time for filing claims against her estate has not expired), which right of contribution would be a right to recover from Mary J. Robinson or her estate to the extent of one-half of the amount of said indebtedness paid by the Ethel M. DuVal estate. What, if anything, on the date of Ethel M. DuVal's death on April 9, 1942, was the fair market value of her estate's said right of contribution which would arise upon such payment being made by such estate at some indeterminate time after

> April 9, 1942, that is to say, at what price, if any, would such right of contribution have changed hands on April 9, 1942, between a willing seller and a willing buyer thereof, neither being under any compulsion to sell or to buy?'' (T. pp. 43-44).

To this question, counsel for the government interposed the following objection:

> ''I would like to object to that question on a couple of grounds, if your Honor please. In the first place, I submit that this witness is not qualified to answer that question because it, in turn involves a legal principle, and to which this man has shown no qualifications.'' (T. pp. 44-45).
>
> ''I object otherwise on the basis that this question is incompetent, irrelevant and immaterial.'' (T. p. 45).

Upon this objection the Court ruled ''I sustain the objection.'' (T. p. 45).

Following this, counsel for petitioners offered to prove by the testimony of the witness on the stand that the answer to the question propounded would be that the right of contribution would have no market value (T. p. 46).

After the objection was sustained by the Court, counsel for petitioners asked the Court, ''Would it be too much to ask your honor on which of the grounds the objection was sustained?'' to which the Court replied, *''Let the record stand as it is.''* (T. p. 46).

Thereupon the witness was asked the following question:

> ''Ethel M. DuVal, who died on April 9, 1942, in her lifetime, with her sister, Mary J. Robinson, endorsed

and guaranteed certain promissory notes for M. K. Blake Estate Company, in favor of Bank of America, N. T. & S. A., in the principal balance of $175,000 and interest thereon at the rate of four and one-half percent (4½%) per annum, which said principal balance remains unpaid and, if Ethel M. DuVal's estate is required to pay the entire amount of said notes at some indeterminate time after April 9, 1942, it will, after making such payment, then be entitled to a right of subrogation, that is to say, a right by means of a civil action to have and enforce any security which said bank or the holder of said notes had at the time of such payment thereof by the estate, which said right of subrogation is not a tangible right of such a nature and character that it can be seized or held or enjoyed independently of a judicial proceeding. What, if anything, on the date of Ethel M. DuVal's death on April 9, 1942, was the fair market value of said estate's said right of subrogation which would arise upon such payment being made by said estate at some indeterminate time after April 9, 1942, that is to say, at what price, if any, would such right of subrogation have changed hands on April 9, 1942, between a willing seller and a willing buyer thereof, neither being under any compulsion to sell or to buy?" (T. pp. 47-48).

Counsel for the Government interposed the same objection (T. p. 48) and the Court sustained the objection (T. p. 48) and exception was taken by petitioners (T. p. 48) who thereupon offered to prove by the witness on the stand in answer to the question his testimony would be that such right of subrogation had no fair market value on April 9, 1942, the date of decedent's death (T. p. 48).

Thereupon the witness was asked the following question:

> "Ethel M. DuVal, who died on April 9, 1942, in her lifetime, with her sister, Mary J. Robinson, endorsed and guaranteed certain promissory notes for M. K. Blake Estate Company, in favor of Bank of America, N. T. & S. A., in the principal balance of $175,000, payable August 2, 1944, and interest thereon at the rate of four and one-half per cent (4½%) per annum, which said principal balance remains unpaid and, if Ethel M. DuVal's estate is required to pay the entire amount of said notes at some indeterminate time after April 9, 1942, it will, after making such payment, then be entitled to a right of reimbursement against the M. K. Blake Estate Company, that is to say, a right to recover from the M. K. Blake Estate Company the full amount paid on its said notes to the holder thereof. What, if anything, on the date of Ethel M. DuVal's death on April 9, 1942, was the fair market value of said right of reimbursement which would arise upon such payment being made by said estate at some indeterminate time after April 9, 1942, that is to say, at what price, if any, would the right of reimbursement have changed hands on April 9, 1942, between a willing seller and a willing buyer thereof, neither being under any compulsion to sell or to buy?" (T. pp. 48-49).

To this question counsel for the Government made the same objection (T. p. 49), the Court sustained the objection (T. p. 49) and petitioners took an exception (T. p. 49), petitioners offering to prove by the witness on the stand that the answer to the question on which the Court had ruled would be that the right of reimbursement would have no fair market value (T. p. 49).

It is submitted, in view of the law as set forth in Specification of Error II that the Tax Court erred in rejecting this evidence.

If the Tax Court believed that *there were no rights over in existence on the date of decedent's death*, as shown in Specification II, it would have been justified in excluding the evidence. But it did not so hold and when we asked the Judge if he would state on which of the grounds he sustained the objection, his reply was *"Let the record stand as it is"*.

This, we submit, is another clear cut error of law.

IV.

THE TAX COURT ERRED IN ARBITRARILY AND CAPRICIOUSLY MAKING A PARTIAL FINDING OF FACT WHICH ERRONEOUSLY CONVEYS THE IDEA THAT THE PLAN FOR DISTRIBUTING DECEDENT'S ESTATE HAS BEEN ABANDONED, WHICH PARTIAL FINDING IS CONTRARY TO THE UNDISPUTED EVIDENCE.

In its Findings of Fact, the Tax Court found:

> "The decedent, by her will, created a residuary trust, naming M. W. Dobrzensky as trustee and as residuary devisee and legatee in trust. Shortly prior to March 15, 1943, a plan was agreed upon between the executors and their attorney (M. W. Dobrzensky) whereby the decedent's estate could be distributed. The plan provided that the entire estate should be distributed to the trustee subject to the payment of the bank's claim. *This plan has never been carried out.*" (T. p. 24.)

The last sentence that "This plan has never been carried out" creates the false impression that the plan was abandoned.

The undisputed evidence is as follows: *The estate has not yet been distributed, but the plan is still in existence and that is the way we will distribute the estate* (T. p .54). *If the maker of the note doesn't pay, the trustee intends to pay the notes if called upon to do so and if the notes are in default* (T. p. 55).

If the finding is intended to mean that the plan for distribution is abandoned, it is clearly contrary to the evidence and in any event creates a wrong impression and is clearly unreasonable and distorts the meaning of the undisputed evidence.

Taken in connection with what is shown in the following subdivision hereof, it is submitted that the Tax Court capriciously ignored evidence that was material, substantial and uncontradicted.

It was material, in considering the conditions under which the Consent to Distribution was *requested* and *granted,* that it be observed that the plan of distribution was in existence and will be carried out.

Otherwise, a fraud would be perpetrated upon the bank.

V.

THE TAX COURT ERRED IN ARBITRARILY AND CAPRICIOUSLY FAILING TO FIND THE FACTS AND CIRCUMSTANCES AND CONDITIONS UNDER WHICH THE ESTATE REQUESTED AND THE BANK GAVE ITS CONSENT TO DISTRIBUTION, WHICH FACTS, CIRCUMSTANCES AND CONDITIONS ARE SHOWN BY THE UNDISPUTED EVIDENCE.

In its Findings of Fact the Tax Court makes another partial finding:

> "In response to a *request* by the trustee, Dobrzensky, the bank on March 17, 1943, sent to him a 'Consent to Distribution' providing that the bank 'hereby consents to distribution of the above entitled estate without payment of its claim, reserving, however, its claim against Mary J. Robinson, who, with said decedent, guaranteed said note."

This finding of a mere request is false and contrary to the substantial and uncontradicted evidence because it capriciously ignores the facts and surrounding circumstances which show *what* was requested of the bank and *why* the request was made—facts which show the true intent of the transaction and negative any thought that the bank *intended* to "relinquish" its claim or "abandon" its right.

The Tax Court should have looked beyond the mere form of this instrument to discover its spirit and purpose. It should not have disregarded the facts and circumstances disclosed by the undisputed evidence (12 *Am. Jur.* p. 776, Sec. 242; 17 *C. J. S.* p. 744, Sec. 321).

The Tax Court, in its opinion makes it clear that it did disregard the evidence of the circumstances and conditions

under which the consent to distribution was *requested* and given because it says (T. p. 27) "From the *tenor* of the 'Consent to Distribution', *especially its specific reservation of the claim against the co-guarantor, we conclude* that as to petitioners, the bank had *abandoned* its claim and *relinquished* its right". This evidence, which the Tax Court disregarded, was material and relevant, if the Tax Court was interested, as it should have been, in knowing *if the bank intended a relinquishment or abandonment.*

The uncontradicted evidence in the record is as follows: On March 15, 1943, M. W. Dobrzensky, as attorney for the executors, telephoned to Mr. A. E. Caldwell (whom he had known for over 20 years), Vice President of Bank of America, the payee of said notes, as follows: *Reminded* him that the bank had filed its claim against the Estate of DuVal for $175,000. *Told* him that the claim had been allowed by the executors and would shortly be presented to the court for approval and that when the claim which was allowed was approved by the court, the estate of DuVal could not be distributed without the bank's consent. *Told* him that, as he had known, under decedent's will, the entire residue of the estate was distributable in trust to M. W. Dobrzensky, as trustee and it was the executors' plan to distribute the residue of the estate to the trustee in trust under the will, subject to the bank's claim and *asked him* if the bank *on that basis* would consent to the distribution of the estate without payment of its claim (T. p. 52). A. E. Caldwell, the Vice President, advised said M. W. Dobrzensky that he *believed* the bank would so consent and would let him know (T. p. 52) and on March 17, 1943, addressed a letter to said M. W. Dobrzensky, as follows:

> "*In accordance with your request,* we are enclosing a 'Consent to Distribution' in the above named estate, reserving our claim, however, against Mary J. Robinson, as a co-guarantor on the note of M. K. Blake Estate Co.
>
> There is also enclosed a Withdrawal of Request for Special Notice." (T. p. 57).

Enclosed with said letter was the "Consent to Distribution".

It is at once clear that the trustee *never asked* the bank to waive or relinquish its claim. The trustee explained what the plan of distribution was and made it clear that the estate would be distributed *subject to the claim.* He asked if "*on that basis*" the bank would consent to distribution *subject to the claim,* but without payment thereof and the undisputed evidence is that the bank sent the consent to distribution "*in accordance with your request*".

The request was that the consent be given so that the estate could be distributed *subject to the claim* and the consent was sent "*in accordance with your request*". It cannot be concluded that the bank *abandoned its claim and relinquished its right.*

The finding is false in that it finds merely that there was a "request" for the Consent to Distribution because this ignores the evidence bearing on the intent of the parties.

"Abandonment" and "relinquishment" are matters of intention and to find merely that the Consent was transmitted "in response to a *request* by the trustee" and without showing what the request was, obscures the real intention of the parties.

Referring to "*relinquishment*" or "*waiver*" it is said in 25 *Cal. Jur.* p. 929, sec. 3:

> "* * * it is a general rule that to constitute a waiver there must be an existing right * * * a knowledge * * * of its existence *and an actual intention to relinquish it* * * *. In no case will a waiver be presumed or implied contrary to the intention of the party whose rights would be injuriously affected. * * *"

And, referring to "*abandonment*", it is said in 1 *Cal. Jur.* p. 10, sec. 7:

> "All the cases agree upon the cardinal rule that there must be no abandonment *without an intention to relinquish possession*—that the existence of abandonment is a question of intent to be determined from *all the facts and circumstances of the case.*"

It is respectfully submitted that the Tax Court's bare finding that the Consent to Distribution was sent "in response to a *request* by the trustee" (without finding *what* the request was) coupled with the fact that the Tax Court construed the Consent to Distribution as an "abandonment" of the claim and as a "relinquishment" of the bank's right *from its verbiage alone* without considering the surrounding facts and circumstances under which it was requested and given and without any finding of fact that the bank *intended* a waiver or abandonment is a clear cut error of law and that the finding, as made, is capricious and arbitrary and is not supported by the *substantial* evidence in the record.

VI.

THE TAX COURT ERRED IN CONSTRUING THE "CONSENT TO DISTRIBUTION" AS A WAIVER OF THE BANK'S CLAIM AND AS A RELINQUISHMENT OF ITS RIGHT.

In the previous subdivision hereof, we have shown that the Tax Court failed to find the facts underlying the delivery of the Consent to Distribution, as shown by the undisputed evidence and, construing only the language of the Consent to Distribution, erroneously concluded that thereby the bank "abandoned" its claim and "relinquished" its right.

This Consent to Distribution is exactly what its name implies, namely, a "consent to distribution" and *does not purport to be a release* of the claim or of the debt.

In order to understand the legal effect of the Consent to Distribution and why the executors requested the consent to distribution without payment of the bank's claim, we must look at the Probate Law of California in order to see clearly that a release or waiver or relinquishment was unnecessary and was neither requested nor given. Section 713 of the California Probate Code provides that:

> "Every claim allowed by the executor or administrator and approved by the judge shall be ranked among the acknowledged debts of the estate *to be paid in the course of administration* * * *".

The general rule is stated in 11b *Cal. Jur.* p. 729, sec. 1247, as follows:

> "*Before there can be any distribution* of the residue of the estate, the expenses of administration, *debts of the deceased,* and legacies prior in time *must be paid,* * * *"

More specifically, the rule is stated in 11b *Cal. Jur.* p. 734, sec. 1251:

> "*Distribution subject to lien or charge of debts.* Creditors are entitled to have the administration kept open until they are paid. A court cannot, over the objection of creditors or *without their consent,* arrest the course of administration, charge the assets with a lien for unpaid debts, legacies and expenses, and distribute the property, burdened only with the charge for the sums due, to be paid at the will of the distributees or when they are compelled so to do by suit to enforce the lien. *Consent,* however, *enables the Court, in its discretion, to make such a decree,* and it may be possible to make a conditional decree that the property be delivered on condition that the distributees concurrently pay the amounts due for legacies, debts and costs of administration.
>
> When distributed property is burdened with a lien the court has power to declare that it shall be taken subject thereto, even though the lien be continuing and accruable contingently; * * *"

The executors, in view of these provisions, through their counsel asked for such a consent and *assured the bank* that the estate would be distributed, under the will, without the payment of the bank's claim, but *subject to the bank's claim. That was the condition upon which the bank's consent was obtained.* As stated in 11b *Cal. Jur.* p. 767, sec. 1275:

> "The heirs or devisees may *consent to a distribution in a particular manner, and the court may incorporate their contract in its decree,* either by express terms or by apt reference, provided the consideration has not in the meantime failed. Such a decree is not prejudicial to other persons, and the representative

is not injured thereby and cannot question the authority of an attorney acting for one of such parties to enter into the stipulation. The consenting parties cannot complain on appeal that the decree departs from the terms of the will."

And the decree of distribution in this estate will distribute the assets of the estate *subject* to the bank's claim.

The probate law of California makes it very clear why a consent to distribution was requested and that such a consent, in law, is not an abandonment of the claim or a waiver of the claimant's right.

In passing, it should be mentioned that the Superior Court, in which the administration of decedent's estate is now pending, will not lose jurisdiction thereof when the estate is distributed. Section 1120 of the California Probate Code provides:

"When a trust created by a will *continues after distribution,* the Superior Court *shall not lose jurisdiction of the estate by final distribution,* but shall *retain jurisdiction* for the purpose of determining to whom the property shall pass and be delivered upon final or partial termination of the trust, to the extent that such determination is not concluded by the decree of distribution, or settling the accounts and passing upon the acts of the trustee and for the other purposes hereinafter set forth. * * *"

The trust assets, which come from decedent's estate, will still be subject to the charge of the liability on the guaranty.

It is a well established practice in California, in the administration of estates where a claim is filed upon a note secured by a mortgage on estate property, of which

we think this Court will take cognizance, for a claimant to consent to distribution without payment of the claim. This does not mean that the estate is released from the debt. The very contrary is meant. *The property remains subject to the mortgage and only payment is dispensed with during the administration of the estate.* The claimant does not relinquish his right to payment. Liability continues.

Payment could be made as well *after* the distribution of the estate, as before. Furthermore, as we have shown, payment is not necessary to allowance of the claim. (Introduction (6).)

A recent decision of the Court of Claims reveals the logic and practical basis of the situation. In *Schiffman v. U. S.* (Ct. Cl. 1943), 51 Fed. Supp. 728, a debt guaranteed by decedent and four others was refinanced and *the estate released.* It was held that no part of the mortgagee's claim was deductible, since the facts showed that *neither the estate nor the beneficiary* ever unconditionally paid or *remained liable to the mortgagee for any amount on account of decedent's guarantee.* At page 732, the Court said:

> "* * * There may be cases where an estate would be entitled to claim and take a deduction on account of the debt of the decedent where such debt was paid by the beneficiary rather than directly by the estate, Cf. *Stone v. White,* 301 U. S. 532, 302 U. S. 639, 57 S. Ct. 851, 81 L. Ed. 1265, 82 L. Ed. 497. We do not find this to be such a case. *In this case it is not shown that either the estate or the beneficiary ever unconditionally paid or remained liable to the Commonwealth Life Insurance Company for any amount on the decedent's guarantee on the mortgage notes of*

> *the Huntsville Hotel Company to the insurance company, in connection with which the deduction is claimed."*

In the instant case, the estate *has not been released* and the consent to distribution without payment of the claim was given so that the estate could be distributed to the trustee, *subject to the claim.*

Here the estate and its assets *will remain liable* and there certainly is no "release".

The agreement was that the estate would be distributed to the testamentary trustee *"subject to" the bank's claim,* not that it would be distributed *"free from"* the bank's claim.

At most, the Consent to Distribution could mean that *payment* of the bank's claim was to be *postponed* until after distribution.

But we have already shown that *payment* of a claim is not a prerequisite to its deductibility. *Liability* is the basis for deductibility and liability always was and now is present.

The Tax Court erroneously attaches undue importance to the fact that the Consent to Distribution reserves the bank's claim against the co-guarantor, Mrs. Robinson.

The Tax Court says that "from the tenor of the 'consent to distribution', *especially* its specific reservation of the claim against the co-guarantor" (T. p. 27) it concluded that the bank abandoned its claim and relinquished its right.

We do not think that any *intention* by the bank to abandon its claim and relinquish its right can be tortured

out of this reservation alone in disregard of the undisputed evidence of the facts and circumstances under which the consent was *requested* by the trustee and *given* by the bank.

In particular, we think that the fact that the bank endeavored to make sure that it would not prejudice its claim against the co-guarantor, Mrs. Robinson, in consenting to distribution of the estate without payment of the claim, is not evidence of an intent by the bank to abandon its claim or relinquish its right.

It is significant that the Tax Court made no finding of fact that such was the intention of the bank and its interpretation of the written instrument, without any consideration of the undisputed underlying facts and circumstances, is a clear cut error of law.

Nor can it be perceived how a consent to the distribution of the state *"subject to" the bank's claim* turns out to mean, in the Tax Court's opinion, a distribution of the estate *"free from" the claim.*

The Tax Court's error in construing the legal effect of the "Consent to Distribution" involved a clear cut error in a determination based on law. *Lum. v. Commissioner* (CCA-3) 147 Fed. (2d) 356, 357; *Union Trust Co. v. Butler* (CCA-3) 84 Fed. (2d) 386; *Millwood Associates v. Commissioner* (CCA-2) 115 Fed. (2d) 871; *Commissioner v. Buck,* 120 Fed. (2d) 774; *McManus v. Commissioner* (CCA-6) 131 Fed. (2d) 670; *Welsback Eng. Etc., Corp. v. Commissioner* (CCA-3) 140 Fed. (2d) 584; *Brown & Sons Lumber Co. v. L. & N. R. Co.,* 299 U. S. 393, 397; 57 S. Ct. 265, 82 L. Ed. 301.

VII.

THE TAX COURT ERRED IN CONCLUDING THAT THE APPROVAL OF THE BANK'S CLAIM BY THE PROBATE JUDGE "WAS A VAIN AND INEFFECTUAL ACTION OF NO LEGAL STANDING OR BINDING EFFECT".

In its opinion, the Tax Court says that "Although the consent to distribution was in the hands of petitioners' attorney at the time, whether or not the court was advised of the action of the bank in filing such consent to distribution does not appear. *We deem this fact to be significant.*"

Later in its opinion, the Court said that "the purported approval of the claim by the Court was a vain and ineffective action of no legal standing or binding effect." (T. p. 28.)

This conclusion is erroneous because the Tax Court has wrongly concluded that the "Consent to Distribution", which the bank gave after being assured that the estate would be distributed to the testamentary trustee, *subject to the bank's claim,* under the plan of distribution that had been adopted, was a waiver by the bank of its claim and a relinquishment of its right. *Neither the trustee nor the bank thought it was a waiver or relinquishment.*

The appropriate time to inform the Probate Court of such a consent is in the *Petition for Final Distribution* of the estate, so as to justify distribution. Under the Probate Code an estate subject to claims cannot be distributed without the payment of the claim, *unless the creditor consents.* (See VI, supra).

There was obviously no need to tell the probate judge, when the claim was presented for *approval,* that the estate

was going to be distributed without payment of the claim under a Consent to Distribution already obtained from the creditor,

First, because neither the trustee nor the bank ever considered the consent as a waiver or abandonment;

Second, because that had nothing to do with the question of decedent's *liability,* upon which the claim was based;

Third, because the Consent to Distribution was not a waiver of the claim or a relinquishment of the bank's right;

Fourth, because under the arrangement with the bank that the estate would be distributed to the trustee *subject to the claim,* it would have been a fraud on the claimant to have sought to have the court refuse to approve the claim.

Finally, as we have shown, the decedent *was liable* on the guaranty and that *liability,* not the payment of the claim, is the legal basis for deductibility.

The Tax Court says "if, in fact, there was no claim by the bank actually *pending* when the court purported to approve the claim, then the court's action was a nullity and without legal effect."

It is obvious that the Tax Court's difficulty lay in its erroneous conception of the legal effect of the consent to distribution.

The Tax Court disregarded the undisputed evidence, as pointed out in Specifications IV and V. *It made no finding of fact that the bank intended to waive its claim and relinquish its right* because the undisputed evidence was the other way.

VIII.

THE TAX COURT ERRED IN CONCLUDING, CONTRARY TO LAW, THAT THE APPROVAL OF PETITIONERS' CONTENTION "WOULD LEAD TO ABSURD ENDS", THUS INVADING THE PROVINCE OF THE CONGRESS, WHICH SHOULD ACT IF THE LAW IS UNWISE OR REQUIRES CHANGE.

The applicable rule is very well stated in 50 Am. Jur. p. 391, sec. 380:

> "*Unwise Results.* It is not the function of a Court in the interpretation of statutes to set forth what the act under consideration should provide, or to vindicate the wisdom of the law. The mere fact that the statute leads to unwise results, is not sufficient to justify the Court in rejecting the plain meaning of unambiguous words, or in giving to statutes a meaning of which its language is not susceptible. An omission or failure to provide for contingencies, which it may seem wise to have provided for specifically, does not justify any judicial addition to the language of the statute. To the contrary, it is the duty of the Courts to interpret a statute as they find it without reference to whether its provisions are wise or unwise, necessary or unnecessary, appropriate or inappropriate, or well or ill conceived. If a change in the law is needed, it is to be effected by the legislature and not by judicial action in the guise of interpretation. However, the wisdom of a law as interpreted under the rules of construction, may operate to bolster such interpretation. It has been declared, moreover, that the courts in construing a statute, should hesitate before ascribing a want of wisdom to the legislature in the enactment thereof."

It is to be remembered that the many cases cited above show that Section 812(b) (3) is clear and unambiguous

and means what it says and says what it means and requires no construction or interpretation. Also, that the right to deduct a claim is a matter of *legislative grace* not resting in the discretion of the Commissioner or dependent on equitable considerations or general rules of law.

The Tax Court invaded the functions of the legislative branch of the government in imputing unwise results to the effect of the law.

CONCLUSION.

Since this Court may arrive at its own conclusions from the record *as to matters of law,* it is respectfully submitted, in view of the clear cut errors of law which the Tax Court has made and which have been pointed out in this brief, that this Court should hold, *as matters of law:*

1. That the decedent's direct and primary liability on the absolute and unconditional guarantees was a proper legal basis for the allowance of a probate claim against the decedent's gross estate under Section 812(b) (3) of the Internal Revenue Code.

2. That the legal effect of the Consent to Distribution was not to work a relinquishment of the bank's claim or an abandonment of the right on which the claim was founded, because the record is devoid of any evidence, and there is no finding, that the bank ever *intended* to abandon its claim or relinquish its right.

3. That it was error for the Tax Court to exclude the petitioners' offered testimony respecting the fair market value of the alleged rights over.

4. That it was error for the Tax Court to invade the province of the Congress and to impute "unwise results" to the meaning and effect of the statute.

5. That it was error for the Tax Court to disregard the uncontradicted and substantial evidence in the record relating to the facts and circumstances under which the Consent to Distribution was requested and given, which evidence shows what the parties intended and that it was error to construe the legal effect of the Consent to Distribution from the words alone, disregarding the aforesaid material evidence and failing to find thereon.

Dated, Oakland, California,
July 9, 1945.

Respectfully submitted,
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